No. 14334

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CHARLES B. SMITH, as Special Administrator of the Estate of EDWARD S. BIRN, Deceased,

Appellant,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC. and WARNER BROS. PICTURES, INC.,

Appellees.

Brief of Appellees, Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc.

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Statement of the Case.

This is a stockholder's derivative suit in which Warner Bros. Pictures, Inc., a Delaware corporation, is the corporation for the ostensible benefit of which the action was brought. At the time of trial the District Court directed that the parties proceed first on the questions of the jurisdiction of the Court and the application of the statutes of limitation. The bar of the statutes of limitation had been pleaded in defense [Tr. pp. 20-26] in addition to general denials.

Extensive evidence was then produced by both sides in turn, both in the form of deposition and by way of testimony of actual witnesses before the Court. Upon close of the evidence, defendants moved for dismissal on the ground that the Court had no jurisdiction and for judgment on the ground that the three year statutes of limitation of California and Delaware constituted a bar. The Trial Court wrote a detailed opinion (117 Fed. Supp. pp. 781-812) which contains much valuable discussion of authority and a full consideration of the factors of law herein involved. It dismissed the first cause of action for lack of jurisdiction and the second cause of action for lack of equity, but felt it unnecessary under such rulings to pass upon the matter of limitation. The argument and authorities presented in this brief do not attempt to duplicate the discussion in the opinion of the District Court.

Discussion of the facts in detail, and with references to the record, will be presented where relevant during the argument but the general picture shown by the record and the actual issues herein are not complex. The corporation is a large one and has outstanding in excess of 3,700,000 of its shares, distributed among approximately 30,000 shareholders. The plaintiff owns 400 of those shares. He alleged that the corporation, hereinafter referred to as Warners, was completely dominated and controlled by the three individual brothers Warner, to wit, Harry M. Warner, Jack L. Warner and Albert Warner, of whom, however, only the first two were named as de-

fendants. The brothers Warner in the aggregate and together owned approximately fifteen per cent of the outstanding stock. They constituted three of the eleven man Board of Directors and were respectively President and Vice-Presidents.

The alleged evil-doing consisted in the making of a contract between Warners and the other corporate defendant, United States Pictures, Inc., for the production of motion pictures by United with financing and for distribution and exhibition by Warners. This contract was made September 28, 1945. The then stockholders of United were Milton Sperling, a son-in-law of Harry M. Warner, and Joseph Bernhard, whose resignation as a director of Warners had become effective a few days prior to the approval of the contract. Sperling had been a producer of motion pictures for a number of years for another major studio at a generous salary and with great success. He had been released by the other studio (20th Century-Fox) after a military interlude in order that he might be available to render services for United. Some time later Sperling and a trustee for his family became the sole stockholders of United.

The Court found at the end of the trial that Warners was not dominated or controlled by the individual brothers Warner and on the contrary found that the contract in question had been entered into in good faith and without fraud and in the belief of the Board of Directors that it was a sound business arrangement for Warners. It found specifically that neither the stockholders of

Warner nor its officers or directors were at any time antagonistic to the financial interests of the corporation and that neither the corporation nor the directors or officers were shown to be at any time under the domination or control of the three brothers.

The Court ruled that as to the first cause of action United should be realigned with the complaining stockholder and that, when such realignment was made, diversity of citizenship was destroyed and with it the sole basis of jurisdiction of the cause in the federal court. As to the second cause of action, it held that, since United had not been named as a party therein but was so indispensable that the action should not proceed without it, that cause should be and was therefore dismissed for lack of equity.

Summary of Arguments.

It is the position of the appellees, Warner Bros. Pictures, Inc., Harry M. Warner and Jack L. Warner, that the conclusions and judgment of the District Court herein as to the propriety and necessity of realignment of the parties with consequent lack of federal jurisdiction are supported by definite and adequate findings of fact and that such findings are amply supported by the record. It is the position of such appellees that, as to the second cause of action, where dismissal occurred for want of equity, the matter was one of discretion and that the discretion of the Court here was properly exercised in the light of the facts. The issues are therefore basically factual, that is to say, whether the findings are so unsupported by the evidence that they must be said to be clearly erroneous and similarly whether the evidence discloses

such a basis that it must be said that the exercise by the Court of its discretion was clearly error and an abuse thereof.

In presenting the argument here, the general arrangement of the appellant will be followed and the questions relating to the first cause of action, and which involve the jurisdiction of the Court as a federal court on the basis of diversity of citizenship, will be first considered. As to this the argument of the appellees may be summarized as an assertion that the realignment of the parties in a derivative suit so as to place the corporation with the complaining stockholder is the general rule, subject to the exception that where improper domination or control by the alleged miscreants are shown such realignment is not made, but that here the findings and the evidence show very clearly that there was no such domination and control and that the general rule and not the exception should apply. As to the second cause of action, it is the contention of appellees that the facts show the controversy involves a contract and its validity; that no final or in fact any determination can be made of the controversy involving that contract without both parties thereto being before the Court; that here, as a matter of his own choice, the plaintiff has not named one of the parties to that contract to be a party to the cause of action, that is to say, United was omitted as a party; and that the nature of the contract and the facts clearly appearing in the record are such that the only proper exercise of discretion was that taken by the Trial Court, to wit, the dismissal of the cause of action for lack of equity.

ARGUMENT.

I.

Diversity of Citizenship Does Not Here Exist and the Realignment Was Proper, Realistic and Required.

The general rule is certainly that in a derivative suit the complaining stockholder and his corporation must be considered as plaintiffs for the purpose of determining citizenship and the jurisdiction which is dependent thereon. This rule is almost a matter of definition in a derivative suit. It is so recognized by appellant though in a negative way and the cases upon which he relies do not hold otherwise. The rule has been developing for three-quarters of a century with a history which has been meticulously traced in the opinion of the District Court herein (*Smith v. Sperling,* 117 Fed. Supp. 781) and which has been reviewed from time to time in the cases as they were progressively decided, such as *Groel v. United Electric Co. of New Jersey,* 132 Fed. 252.

The reason for the rule is clearly recognized. A corporation is itself an entity or artificial person which the complaining stockholder asserts to be under some disability requiring that the stockholder as a self-appointed "next friend" or guardian bring suit on its behalf and for its benefit. Courts have so described the relationship. (*Koster v.* (*American*) *Lumbermens Mutual Casualty Company,* 330 U. S. 518 at 522-523; *Illinois Central Railroad Company v. Adams,* 180 U. S. 28 at 34.)

As an exception to the general rule, the corporation is aligned or classified as adversary to the complaining stockholder in those proper cases where the corporation is so completely dominated by the individuals alleged to be miscreants that the corporation has no will of its own

but is practically the *alter ego* of the alleged miscreants. There are such cases and appellant at the outset cites several including *Venner v. Great Northern Railway Company,* 209 U. S. 24, 52 L. Ed. 666; *Doctor v. Harrington,* 196 U. S. 579, 49 L. Ed. 606; *Central Railroad Company of New Jersey v. Mills,* 113 U. S. 249, 28 L. Ed. 949; and *Cutting v. Woodward,* 255 Fed. 633. In the first three of such cases, the realignment was made upon the basis of the bill or complaint, in which circumstances, of course, the allegations in the bill or complaint were accepted as true and at face value, and in the fourth the Court had found the charges to be true.

In *Doctor v. Harrington,* it was alleged that Harrington, the individual defendant, had the voting power of a majority of stock and

> "directed the management of the affairs of the corportation, dictated its policy, and selected its directors;"

and that the second corporation involved was "likewise controlled" by Harrington. In *Venner v. Great Northern Railway Company, supra,* the individual defendant was the late James J. Hill. The complaint alleged that Hill was a director of the railway company and its president and

> "that the railroad and its board of directors were under his absolute control"

and that

> "while holding these offices and exercising this control"

he caused the corporation to purchase from him personally owned stock in another railroad at a huge profit to the individual.

In the latter case it was the stockholder urging that his corporation, the railroad, should be aligned with him as the plaintiff so that the case could be remanded to the state court. The defendants were resisting remand after having caused removal in the first place. Appellant appears to assume that the Supreme Court in the *Venner* case was testing the railroad company—as an entity—as to its attitude toward the matter and he also urges that the rationale of this case was the same as *Groel v. United Electric Co.* (Op. Br. pp. 22-24). It is plain from each of these cases that a corporation, being artificial, can have an attitude only through the officers or persons in control and that, if those officers or persons in control are the alleged individual miscreants, then the corporation has no separate mind of its own or any separate attitude of its own and should be regarded precisely as the alleged individual miscreants themselves. In such a case the corporation's attitude to the objects of the action is hostile to the plaintiff and in such cases it will not be aligned with the plaintiff, even though as in the *Venner* case the plaintiff himself wished it to be so aligned.

In *Cutting v. Woodward,* 255 Fed. 633, there had been a trial but the Court had found that a purported sale of assets to the president of the company had been the merest sham, that the president had virtual control of the majority of the Board, that they were always ready to do his bidding and that the circumstances constituted actual and not merely constructive fraud. On appeal the Court found no reason to disturb these findings of fact and they must therefore be assumed to constitute the basis of the decision. In the case now at bar, the situation is completely to the contrary for here the findings are all

the other way and determine that there was no fraud and no domination. As is shown herein, these findings should not be disturbed for they are amply supported by the record and with an opposite factual basis the conclusion is necessarily opposite as well.

In the remaining case cited by appellant on the matter, *Central Railroad Company of New Jersey v. Mills,* 113 U. S. 249, 28 L. Ed. 949, the ruling again was upon the pleadings in removal and remand proceedings and naturally the factual basis was taken to be the fraud and illegality as charged in the complaint.

Appellant then follows with a group of decisions (Op. Br. p. 27) in connection with his general assertion that. if the actions of the president of a corporation are challenged, a court of equity will not invoke the business judgment rule. It is submitted that the cases cited do not establish that a court of equity will "lay aside" the business judgment rule and scrutinize such transactions with a view to determining their legality and fairness. Actually, this is putting the cart before the horse as is evident from the cases cited. In *Pepper v. Litton,* 308 U. S. 295, 84 L. Ed. 281, for example, a one-man corporation was in bankruptcy and the claim of the dominant and controlling stockholder of that one-man corporation was involved. The findings of the Court there, which were amply supported by the facts, showed the clearest kind of fraud. The Court said that the dealings of a dominant or controlling stockholder with his own corporation will be subject to "rigorous scrutiny." Similarly, in *Remillard Brick Company v. Remillard-Dandini Company,* 109 Cal. App. 2d 405, the control described by the Court was complete and the holding was primarily that mere disclosure to the minority, by the dominant power, of an intent to raid or mulct the

corporation, does not automatically put that dominant power in the clear.

Detailed analysis of further authorities in this group would serve no useful purpose. Certainly a scrutiny of a challenged action should be made, and when control or domination is asserted there should be rigorous scrutiny, but such scrutiny is primarily to see if there is control as alleged and, if there is, then to see if the transaction is in the financial interests of the corporation. Here in the case at bar, the matter of domination and control was fully presented by the parties and was subject to rigorous scrutiny, and after such scrutiny the Trial Court found that there was no such objectionable domination but that the Board of Directors had acted independently and in the exercise of good business judgment.

Appellant also uses the word and emphasizes the *attitude* of the corporation (Op. Br. pp. 24 and 29) and this term does appear in *Cutting v. Woodward,* 255 Fed. 633, and also in *Delaware & Hudson Company v. Albany & Susquehanna Railway Company,* 213 U. S. 435, 53 L. Ed. 862, but the question is, more accurately, whether in the language used by the Court herein (but answered in the negative by the Court), the corporation was

> "under control antagonistic to the financial interests of said corporation and its stockholders" [Tr. p. 77].

These cases, as leading cases in the field, establish the rule and its reason. In *Groel* and *Venner* and others cited by appellant, the corporation was not realigned under the general rule but remained aligned among the defendants under the exeception based upon the matter of control and domination. As noted, in three of these cases there had been no trial of fact on the subject of diversity,

and the domination, which is the critical factor in testing the so-called attitude of the corporation, was taken as pleaded, and in the other the Court had found domination as a fact. In the present case the rules applicable are, of course, the same but there has been a trial of the issue and the Court has found domination did not exist.

The District Court here found [Finding IV, Tr. pp. 74-75] that there were eleven members upon the Board of Warner Bros. Pictures, Inc. The two brothers Warner, that is, Harry M. and Jack L. Warner, are individual defendants named herein. They with their brother Albert were three of such eleven. At the time of the execution of the base contract herein involved, the brothers Warner, as individuals, owned less than twenty per cent of the outstanding stock of the corporation

> "and that neither the corporation nor the directors or officers were shown to be at that time or at any time under the domination or control of the three brothers Warner above named."

It also found in Finding V [Tr. p. 76] that the stockholders of the corporation were not at any time, nor at all, under the domination or control of the three brothers Warner, nor was the Board of Directors dominated or controlled by any of the individual defendants. The District Court concluded [Conclusion II, Tr. pp. 78-79] that the stockholders, directors and officers were not dominated by the brothers Warner, nor any of them, and that the corporation was not and had not been in the hands nor under the control of persons antagonistic to the interest of the corporation in this action.

In the *Venner* and *Groel* cases, for example, the complete and absolute domination and control by the individ-

ual defendants were taken as true merely because the plaintiff so claimed, but here after trial, and as a factual matter, the District Court has found and concluded otherwise, and under Rule 52 of the Rules of Civil Procedure these findings at the trial should not be set aside or disregarded unless they are clearly erroneous. The findings are responsive to the facts, and clear, or any error has not been and cannot be shown. Such Findings are supported by ample direct evidence and by necessary inference from many facts of different kinds as hereafter set forth.

The record shows that the Board of Directors of Warner Bros. Pictures, Inc. consisted of eleven members including the three brothers [Tr. p. 74] and ten of these members, that is, Messrs. Friedman, Perkins, Wolf, Guggenheimer, Catchings, Carlisle, Schneider and J. L., Harry and Albert Warner, were directors at all times relevant here. The eleventh man prior to September 25, 1945, had been Joseph Bernhard. Between that date and November 23, 1945, that particular office was vacant and since that time the remaining member has been John Bierwirth [Stp. of Facts. Tr. p. 27].

The testimony of most of these persons on the subject of influence, domination or control appears in the record. Appellant (Op. Br. pp. 31-32) argues that the Board and the corporation were controlled by or under the "working control" of the three brothers Warner and such assertion seems to be based on inference from the facts that four members of the Board were lawyers employed by or on retainer to the corporation and two were salaried employees of the corporation (Op. Br. pp. 8-9) and that their re-election as directors might be prevented. Appellant cites the salaries and retainers paid (Op. Br. p. 8)

from which it appears that the purely venal standard of money received as salary or retainer is being applied, and that in so doing appellant does not distinguish between control or domination on the one side and reliance by directors on information and recommendations made by persons known to the Board as highly capable executives who had demonstrated their abilities by many years of success in their respective fields, even though such executives were the brothers Warner.

The Court found that the three Warners held less than twenty per cent of the outstanding stock of the corporation [Tr. p. 75] and the Stipulation of Facts [Tr. p. 28] showed that actually, at all relevant times, they owned approximately fifteen per cent between them. There were outstanding 3,701,090 shares [Tr. pp. 27-28] which were held by an aggregate of about 30,000 shareholders [Tr. p. 120]. Appellant states as a fact (Op. Br. p. 3) that the brothers Warner had a "working control of the company" but clearly on the facts no such control of either the stockholders or the Board of Directors could be legitimately inferred as a result of ownership by them of shares of stock in the corporation. The members of the Board of Directors are elected by the stockholders at annual meetings, each director being elected for a two year term after nomination by the Board; five directors being elected in one year and six in the next [Tr. p. 305; and Op. Br., Appendix A, p. 2]. A proxy committee solicited proxies from shareholders to be voted for the nominees of the Board (see proxy statement, Op. Br., Appendix A, p. 2).

The basic agreement between the corporation and United States Pictures was presented to the Board and approved

by it at a meeting held September 28, 1945, at which meeting there were seven members present, that is, Messrs. Albert Warner, Carlisle, Friedman, Perkins, Catchings, Guggenheimer and Wolf (Op. Br., Appendix D, p. 13). On that date there was one vacancy on the Board as already noted and the absent directors were J. L. and Harry Warner. It might be remembered in this connection that absent directors cannot vote by proxy (*cf. Lippman v. Kehoe Stenograph Co.,* 11 Del. Ch. 80, 95 Atl. 895) and cannot delegate their duties or assign their powers. Each of the directors present, as well as those who were present at meetings though not members of the Board, gave direct testimony as to the situation. Appellant has, in addition to pointing out the amounts received by a number of these persons from the corporation, but in each case in a capacity other than as a director (Op. Br. p. 8), indicated (Op. Br. p. 9) that Harry Warner had influence with them. The extent and character of any such influence as shown by the testimony noted by appellant, however, does not show control or domination with respect to this or any particular situation or question, nor even as a general matter. Nevertheless, from such testimony appellant infers a general influence and then, on such basis, infers specific influence and domination. The Trial Court did not draw any such inference but found, as noted, that the Board was not controlled and dominated by the three brothers Warner.

One of the directors, Waddill Catchings, testified that he was legally trained and had been with Sullivan & Cromwell [Tr. p. 243] and later had been associated with financial interests such as J. P. Morgan & Company and Goldman, Sachs & Company [Tr. p. 244]. He had gone on the Board of Warner Bros. as a representative

of the owners of stock underwritten by his firm. He was still a director of a considerable number of large corporations such as Chrysler Corporation, Sears, Roebuck, etc. [Tr. p. 245]. He had no connection with Warner Bros. except as a director for which he received a fee of $50.00 per meeting [Tr. p. 246]. He had been at the meeting of September 25, 1945, and the meeting of September 28, 1945. He had voted each time and no one at that time or in connection with such matters had told him how he should vote, but he had voted in the exercise of his own independent judgment [Tr. pp. 247-248-249], and considered the contract to be a good contract from a business point of view. This was also the case with respect to an amendment of the contract in 1946 [Tr. p. 254] and also in 1950 [Tr. p. 257]. He was aware that Milton Sperling was a son-in-law of Harry Warner and that [Tr. pp. 258-259]:

> "I couldn't fail to give consideration to the fact; but it certainly did not influence my voting in favor of any of the contracts."

On cross-examination, he stated his opinion [Tr. p. 261] that

> "I have never felt that the Warner brothers were dictating to me as a member of the Board as to what names to submit to the stockholders"

with respect to the nomination of candidates for the office of director, but that

> "the Warner brothers express their opinion, and anybody else that has any opinion is entitled to express it * * *."

When asked in cross-examination whether it would be an unfair statement to say that, if the Warner brothers

so desired, a person would be kept off the list of candidates, he testified that he would not so state and that it was a matter of pure speculation what would happen if there should be a difference of opinion between the Warner brothers and those who were not connected with the company or the family, and that he had never seen any indication of any attempt to force any candidate on the Board by Harry Warner [Tr. pp. 262-263]. The Warners had never had open and shut control and that in the past, if he had come into conflict with the Warners, he might have been able to push the Warners around [Tr. p. 264]. In his opinion, Bierwirth, Guggenheimer and Wolf were certainly independent. On the specific contract, it had been recommended by Harry and Jack Warner, and he placed great faith in the recommendations from those in charge on the Coast [Tr. p. 268].

C. S. Guggenheimer testified he was a practicing attorney and had been a director of many corporations. His firm was under retainer from the corporation but Warner Bros. was not its principal client [Tr. pp. 270-271]. At the meetings here relevant he had definitely used his own independent judgment [Tr. p. 273] and no one had stated directly or indirectly how he should vote [Tr. pp. 275-276] and that, with respect to the United States Pictures deal, definitely no person made any suggestions, requests or directions as to how he should vote on any of the matters [Tr. p. 278]. He did not remember that Albert Warner, who presided at the meeting, had ever actually made any recommendations [Tr. p. 282]. He personally represented 200,000 shares at one time and still represented 50,000 or 60,000 shares and was on the Board for that reason [Tr. p. 284] but that, unless his clients wanted him to battle with the

Warners, he would probably not try to remain a Board member if the Warners did not want him on the Board [Tr. pp. 284-285].

Morris Wolf was also a practicing lawyer in Philadelphia, had been a director for many years and was at these meetings. He was not told or instructed by anyone how to vote [Tr. pp. 287-288]. In fact, there were no suggestions or instructions by anyone [Tr. pp. 289-290]. He did not think he could be elected to the Board if the Warner brothers opposed it and, in fact, if anyone in authority indicated the services of his firm were not required, he would acquiesce [Tr. pp. 291-292].

Most of the other directors testified to much the same situation and indicated quite positively that so far as the particular witness was concerned his action on the Board, and certainly in connection with the United contract, was quite independent, was in the exercise of his best judgment and that he had been given no directions or requests or orders of any kind as to how he could vote or what attitude he should take [*e. g.,* see Carlisle, Tr. pp. 177, 182, 187, 188; and Perkins, Tr. pp. 297, 298, 300, 304; Albert Warner, Tr. pp. 237, 239, 240; McDonald, Tr. p. 224; also *infra* this brief].

Appellant (Op. Br. pp. 8-9) himself presents references to the evidence from which he, but not the District Court, infers that these directors were subject to domination and control. The inference is based upon the fact that Friedman, Perkins, Carlisle and Schneider were employees of the corporation at substantial salaries and that Wolf and Guggenheimer were respectively members of legal firms in Philadelphia and New York which received retainers from the corporation in the year 1945 for pro-

fessional services. However, as noted herein, Guggenheimer's other testimony negatived any inference of domination merely from the receipt by his firm of a small retainer and the same was true of Mr. Wolf. Moreover, the testimony of Wolf that he would acquiesce if anybody in authority in the corporation indicated that his services were not desired any more, very clearly referred to his services as a lawyer or the services as his firm in a professional capacity and had no reference to his specific capacity as a director [Tr. pp. 291-292].

Messrs. Perkins and Friedman testified at length, the former by deposition and the latter in person. Perkins, whose compensation was received in his capacity as Vice-President and General Counsel of the corporation, on cross-examination testified that as a director he was elected for two years by the stockholders and that he was nominated as a candidate for the Board by the Board itself. The Warners had considerable influence with the Board [Tr. p. 305]. He was then asked specifically if, at the end of a term of office the three brothers Warner desired to see to it that the witness was not nominated for the ensuing term, the brothers Warner could succeed in their desires and keep him off the slate. His reply was that he did not know, but whether he would himself be a candidate was different and that he did not believe he would run as a candidate [Tr. pp. 305-306].

Mr. Friedman testified that he was a Vice-President of the corporation as well as a member of its legal department at the home office [Tr. pp. 444-445]. When asked concerning the procedure of the Board with respect to the nomination of its members, he stated unequivocally that Harry Warner did not control the naming of such candidates for the Board of Directors [Tr. p. 487]. He

was asked whether the three brothers Warner controlled his continuance in office as an attorney and he stated that [Tr. p. 490] if, as an attorney, he became *persona non grata* to any of the Warners or any other executive of the corporation he would feel that his professional services were no longer required and he would resign as an attorney. So far as the brothers Warner were concerned, this was not because they were the holders of any proportion of the stock but because they were the chief executive officers.

The actual testimony as to what Messrs. Perkins and Friedman said with respect to resignations is substantially different in meaning and effect from that indicated by appellant (Op. Br. p. 9), because the testimony refers only to their professional capacity as employed attorneys and does not refer, nor is there any mention of any such action, to resignation in connection with their capacity as directors. Mr. Friedman also testified that he did not consider that the brothers Warner had control, either actual control or working control [Tr. pp. 490-491]. He regarded the ownership of fifteen per cent of the stock as a nucleus to which other stock could be attracted by proxy and that that was the extent by which the brothers Warner had any advantage over any other stockholder [Tr. p. 491]. He testified also, and we submit that it is a fair analysis [Tr. pp. 491-492], that the brothers Warner had been executive officers of the corporation from its inception, had brought the corporation through many serious vicissitudes and had done well for the corporation and that as a result of such abilities, and with their fifteen per cent stock ownership as a nucleus, they could obtain the vote of many stockholders by proxy for the reelection

of directors. Their opinions as executives were much valued and, by virtue of such past history and their success over the years in management of the corporation, the brothers Warner might be said to control the basic policies of the company but not because of any ownership of any particular stock [Tr. pp. 492-493]. With respect to the United contract and the meeting at which it was adopted, Albert Warner had indicated to the Board that he believed the United agreement would be an agreement to the advantage of the corporation and recommended its adoption. He did not think that Albert Warner had said that Albert, Harry and Jack would like to see the Board adopt or approve the contract but merely that the brothers Warner wished the contract to be submitted to the Board for its consideration and that Albert recommended its adoption [Tr. p. 493].

The testimony of the directors, singly or together, as to the status, behavior and influence of the brothers Warner is very similar to that considered in *Solamine v. Hollander,* 128 N. J. Eq. 228, 16 A. 2d 202. The opinion is very comprehensive, but as its last point (16 A. 2d at 246) the Court said:

> "It is claimed that the Board of the Hollander Company has been dominated by the three Hollanders. Unless that fact is to be inferred from the mere circumstance that the three Hollanders were the chief developers of the company's business, are the seniors in point of service, and are men of wide experience in their industry, as shown by the testimony, there is no evidence to support the charge. * * * It is easily understood that his (M. Hollander) position and personality have made him a commanding figure in his company, and that his fellow officers and

directors respect his business judgment. This however does not spell out that domination which the cases deem objectionable. There does not appear in the evidence a single instance where any or the three Hollanders imposed their will against the judgment of their co-directors."

In conclusion upon this matter of domination, the testimony already noted is also persuasive from a slightly different aspect. The brothers Warner had about fifteen per cent of the stock of the corporation. Their personal experience and success attracted the participation of other stockholders, though the record does not show how many or what percentage of shares of other stockholders was given by proxy to the brothers Warner at any given annual election. However, the members of the Board were elected for two years. It is elementary that a director can be removed only by the stockholders and not by his co-members on the Board. It seems obvious that it would be quite a different thing to attract and secure proxies of enough stockholders to cause the removal of one or more directors as a special and punitive step than to secure a sufficient number to elect one or more directors at an ordinary routine annual meeting. The members of the Board who testified as above did not say that they would resign as directors, even when they were among those referred to by appellant as the "inside" directors. As directors no real threat or pressure could be put upon them under the circumstances except through the application of the venal standard suggested by the appellant. There is, of course, in the record nothing to indicate that any of the directors were other than men of personal strength and integrity who would not be controlled on any such basis, nor that there was

a single instance shown in which such intergrity and independence had in fact been surrender.

We submit that, on the record, it is perfectly clear that the realignment made by the Court was proper and required, and that there was no diversity of citizenship and hence no jurisdiction in the Court as a federal court as to the first cause of action.

II.

Dismissal of the Second Cause of Action by the Court Was a Proper Exercise of Discretion.

The District Court herein dismissed the second cause of action for lack of equity because United was not named (neither was Sperling) in such cause of action but was in the Court's opinion a party which ought to have been joined [Tr. pp. 78-79; Op. 117 Fed. Supp. 810]. Appellant in this respect argues (Op. Br. p. 33 *et seq*) that a court of equity should go as far as it can in granting relief and should not withhold its power merely because complete relief cannot be accorded. He asserts (Op. Br. p. 33) that this cause of action obviously sought no more than that Harry and Jack Warner be adjudicated as guilty of a breach of trust and be ordered to respond in damages for their asserted misconduct, and that it sought nothing whatever from United as the omitted party.

Under appellant's description, his second cause of action merely requests a money judgment against two individuals with no other relief possible or requested which would be essential to such a judgment. If this were the situation, there would be no reason for the exercise of any of the special powers of an equity court, though the argument of appellant is based upon the idea that the Trial Court was a court of equity and "will strain hard" (Op. Br.

p. 37) to determine the merits. The District Court herein is concerned not only with its jurisdiction as a federal court but also with the quite distinct questions involved in the included but separate jurisdiction as a court of equity (*Tucker v. National Linen Service Corporation,* 200 F. 2d 858 at 863). In a case where the only possible relief requested could be given in a court of law, *i. e.,* a money judgment alone, the jurisdiction of equity is merely concurrent, and its aim should be to see that its forum is not abused.

Here, United is before the Court and was before the Trial Court under the first cause of action. There was no question of difficulty or inconvenience in finding or serving a party but appellant, as plaintiff, of his own choice omitted this party as well as Sperling in the second cause of action. We submit a court of equity will not strain very much under such circumstances. It cannot be so forced by the voluntary act of a plaintiff. On the contrary, he who seeks equity must do equity and in any such case, as is said in *Koster v. Lumbermens Mutual Casualty Company,* 330 U. S. 518 at 522, 91 L. Ed. 1067 at 1072, the Court,

> "will be alert to see that its peculiar remedial process is in no way abused."

Furthermore, appellant's description of his second cause of action is at variance with his pleading, both as to the actual allegations of the second cause of action and the prayer of the complaint. It further disregards the facts shown by the record which are relevant to the exercise by the court of its discretion as a court of equity and under Rule 19, F. R. C. P.

Appellant correctly notes that with respect to the second cause of action there was diversity and hence federal

jurisdiction, the actual action of the court being an exercise of discretion within that jurisdiction. It was also a denial that the facts gave it jurisdiction to proceed as a court of equity. Appellant cites *Young v. Powell,* 179 F. 2d 147, and includes a quotation (Op. Br. p. 36) which was in turn a quotation by the Court from *Hudson v. Newell,* 172 F. 2d 850. The portion quoted sets forth certain "fundamental principles" which are undisputed and in fact largely paraphrase Rule 19, but those principles were not applied in the *Young* case and cannot be here applied with the effect appellant desires.

In *Young v. Powell* the action was by one residuary legatee against another residuary legatee to set aside certain gifts and cancel an instrument. Other residuary legatees were not named as parties. The Trial Court had refused to dismiss on the ground that the other legatees were not parties and had in fact granted relief which happened to be beneficial to the omitted parties. The Court of Appeal (5 Cir.) very definitely rejected this as a factor and dismissed the action for absence of parties, indicating that it was the relief *asked* which was the guide to determining the dispensability of parties and that otherwise Rule 19 would be a "delusion and a snare."

Here the second cause of action repleads all of the allegations of the first cause [Tr. p. 11] except Paragraph 11 of such first cause, which asserted a conspiracy among the individual defendants. Among the allegations so repleaded, the appellant asserted in Paragraph 25 that he had no adequate remedy at law and that there would be,

> "irreparable damage unless the relief requested herein be granted."

The relief requested consists of five items [Tr. p. 15] of which the fourth is costs and fees of the plaintiff and the fifth is merely for general relief. Item one asks an accounting for losses and damages suffered by Warner and for all profits and benefits received by the defendants and that the defendants make restitution. There were in fact no allegation anywhere that the individuals who alone are named in the second cause of action, that is, Harry and Jack Warner, had ever received any profits or benefits or anything else which they could restore. Items two and three prayed that a trust be impressed on the capital stock and assets of United and that the agreement between Warner and United, so far as the same is unexecuted, be cancelled and terminated.

It would certainly appear that appellant in his complaint asserted that the damage would be irreparable unless many things were done. His present argument urges that all he asked for in effect was a money judgment against Harry and Jack Warner. It is submitted that it is the allegations and the prayer of the complaint which are here the guide and not the present assertion of the appellant. This is indicated by the Court in *Young v. Powell, supra,* on which appellant relies. It is quite obvious that by far the greater part of the relief requested could not be given in the absence of United and Sperling and that no money judgment against the two individuals named could remedy the "irreparable damage" asserted to exist.

Rule 19(b) provides first that, if a party is omitted who is not indispensable but who ought to be a party and who is available, the Court will order that party brought in if to do so would not destroy jurisdiction. It is true here that United was easily available but to order it brought in as a party would destroy diversity

and hence jurisdiction to the same extent as was the case with the first cause of action. The Court did not order United brought in. The rule then provides that, if there are such parties who ought to be in, but jurisdiction would be destroyed if they were brought in, the Court in its discretion may proceed with the action without such parties and the judgment will not affect the rights of those absent. Here the Court concluded that, while not stating that United was an indispensable party in the absolute sense, it was so necessary and indispensable that a final determination of the cause without United would not be equitable [Tr. pp. 78-79; Op. 117 Fed. Supp. 810]. Under the rule, even if United were not actually indispensable, the Court had discretion to proceed with the case or to dismiss it and it exercised that discretion in favor of dismissal. It is submitted that the basic question is whether that discretion was abused under the circumstances.

As already indicated, there are a number of facts in the record which we submit show very clearly that the dismissal was a proper exercise of discretion. The discrepancy between the actual allegations and the prayer of the complaint, particularly the second cause of action, and the argument thereon and the description thereof by the appellant have already been noted. The record also shows, and appellant asserts, that the contract between Warner and United made in 1945 had been subject to successive amendments and that such agreement as a whole provided for the production of thirteen photoplays of which eight had been made (Op. Br. pp. 16-17). The contract was therefore executory as to five photoplays. The photoplays themselves were divisible into two classes so far as terms were concerned and of the remaining or executory

photoplays, three were so-called original pictures under the 1945 agreement, and two were the so-called additional pictures provided for by the amendments. On the original pictures, Warners agreed to furnish financing to the extent of fifty per cent, to distribute the pictures at a distribution charge of twenty per cent domestic and twenty-five per cent foreign of the gross proceeds and was entitled to fifty per cent of the net proceeds [Op. Br. p. 14; Tr. pp. 525-526]. As to the additional pictures, Warners was to furnish one hundred per cent of the financing, to distribute at a fee of twenty-five per cent domestic and higher abroad, and would be entitled to eighty per cent of the net. Which of the arrangements might be the more beneficial to the corporation is not here relevant, even if it were demonstrable, but the approximate terms and the fact that the unmade pictures, to be produced before January 1, 1956, were substantial in number and might be made under different conditions, are facts in themselves bearing upon the exercise of discretion by the Court. Under the contract any net losses on one picture were to be recouped from profits, if any, on subsequent pictures (Op. Br. p. 17). Further, such contract provided (Op. Br. App. p. 17) that, if there was any deficiency four years after the release of the last photoplay, United would pay the amount of the deficit, so there would be no loss unless United were then insolvent. The query is appropriate, we believe, as to the possibility of any kind of final determination by way of a present money judgment against two individuals under the second cause of action when such an executory contract would be left outstanding under which it could not, at any given time, be told whether there would be profits or losses or whether the venture as a whole would result in profits or losses.

More to the point than *Young v. Powell* are the two cases in this circuit of *Washington v. United States,* 87 F. 2d 421, and *Pioche Mines etc. v. Fidelity Philadelphia Trust Co.,* 202 F. 2d 944. The *Pioche* case, together with *Tucker v. National Linen Service Corporation,* 200 F. 2d 858 (5 Cir.), furnish, we submit, the standards and principles which are here directly applicable.

This Court in *Pioche v. Fidelity, supra,* quoting from *Washington v. United States,* sets forth (p. 947) four questions and states that if all four are answered in the affirmative then an absent party is a necessary party, but if *any* of the questions are answered in the negative, then the absent party is indispensable. These questions are (1) Is the interest of the absent party distinct and severable? (2) Can justice be rendered between the parties before the Court? (3) Will such decree have no injurious effect on the interest of the absent party? (4) Will the final determination be consistent with equity and good conscience in the absence of such party?

In *Tucker v. National Linen Service Corporation,* 200 F. 2d 858, it is said that it is perfectly clear that where cancellation, reformation or other equitable relief is asked in respect of a contract, all of those having an interest in the contract or who will be affected by the decree are indispensable parties and must be before the Court (p. 863). The Court then explains

> "This is so because, while the absence of indispensable parties as such does not go to the jurisdiction of the Court as a federal court but to its jurisdiction as a court of equity, if federal jurisdiction depends wholly upon diversity of citizenship, such jurisdiction may be maintained or defeated by the presence or absence of indispensable parties, as the case may be. In so far, therefore, as the suit sought the equitable relief

> of cancellation and its incident, an accounting, as to certificates of stock now standing in the names of persons who are not, and cannot be made, parties to the suit without destroying diversity jurisdiction, the district judge was clearly right in dismissing the action for want of these indispensable parties."

The four questions in *Pioche v. Fidelity* cannot be answered entirely in the affirmative here and this is plain from the explanation given by the Court in *Tucker v. National Linen Service Corporation.* Certainly the interest in a contract of one party to that contract cannot be different in character from that of the other party to the contract so as to be completely severable and treated as a thing by which that other party will not be affected. Certainly any decree affecting that contract will likewise affect the absent party to that contract and may do so injuriously. The fact that a decree on the merits might be beneficial to the party is immaterial as is evident from *Young v. Powell.* The necessity for affecting the contract between United and Warner by any decree herein is to be tested by the complaint, under the cases above cited, and not by the present description of appellant. Any decree or judgment against the two individual brothers Warner adjudging them guilty of misconduct in promoting the contract relationship between Warners and United and Sperling, such as appellant now says he wanted, must of necessity go to the roots of that contract from its inception and, if the decree against the two Warners were as prayed to the effect that they were so guilty of misconduct, the interests of United would certainly be affected adversely or injuriously thereby. Furthermore, as shown from the facts, there could be no justice or equity in any present money judgment against the individual Warner brothers for asserted damages due to misconduct

in connection with the United action, since the transaction is presently largely executory and there cannot possibly be any determination of any final amount of damages or loss under such circumstances, though as of the time of trial there appeared to be very large overall profits rather than any losses at all [Tr. pp. 528, 529, 552].

The questions propounded in *Washington v. United States, supra* and *Pioche v. Fidelity, supra,* take as their premise the fact that the party or parties absent from the action must be interested in the controversy. Certainly United and Sperling are interested in the controversy. It is that "interest" which is the subject of the questions then propounded. The controversy certainly involves the validity of the contract between Warners and United. All parties to that contract are certainly interested in that matter of validity and propriety of the contract. The interest of United is directly in the contract, and the interest of Sperling as a stockholder and employee of United also extends to the contract. We again submit that the interests of United and Sperling as the absent parties are not a severable part of the controversy and that it certainly cannot be said that any decree made which will or can affect or establish the validity or invalidity of that contract will not have some effect on the interest of the absent parties.

In *Pioche v. Fidelity,* 202 F. 2d 944 and *supra,* the Court, after putting the questions, answered them as to their application to the facts of that case, which involved a contract between a named party and an absent party. This Court there (p. 948) stated positively that it was unable to see how justice could be rendered between the parties then before the Court since the controversy involved the assertion that the parties had not performed their obligations thereunder and that no order which would

cause performance could be made against the absent party. There is little essential difference here and we submit the same would be true in practically any case in which the subject matter of the controversy is a written agreement between specific parties when only one of such parties to the contract is a party to the action.

In any case it is submitted that the relevant questions cannot all be answered in the negative and hence, as held by this Court in the cases cited, the absent parties are indispensable. If so, the cause had to be dismissed. If they were not indispensable, but should have been present, the Court had discretion.

We have therefore a situation where the District Court had at very least a discretion as to whether to proceed with the second cause of action or to dismiss it. It may have had the obligation to dismiss, and not merely discretion, but there was certainly no obligation to proceed. In the exercise of its discretion, some of the relevant elements have been already discussed. If the trial went forward, only a money judgment could result and that money judgment could not possibly be complete or final in any sense. No fixed amount could be settled which could with any certainty be said to represent any damages or losses so long as it could not be certain that there would be under the contract any loss or damage whatsoever or any indirect loss or damage on the theory of possible profits which might have been obtained had funds not been diverted. There are a substantial number of photoplays yet to be produced. Each one might produce either a profit or loss. If all of them produced a loss, then at the end of the road a sum could be fixed to represent the accumulated loss, but only if United were insolvent and could not itself pay any deficit. However, under

the contract a profitable picture might wipe out all prior losses and create a net profit, and as for all but one of the pictures has been profitable.

We have above described certain possibilities since the possibilities have a direct bearing upon the propriety of the exercise of discretion. However, the facts, as of the time of trial, are even more persuasive in assessing such exercise. Mr. Schneider, a vice-president and director, testified that the ninth picture was then being produced [Tr. p. 527] and that of the eight already produced one showed a loss but seven showed or would show a profit, so that [Tr. pp. 528-529] the corporation would have a net profit of one and one-half million dollars besides collecting five and one-half to six million dollars as distribution charges and a million dollars profit in the theatres owned. Query: Is it an abuse of discretion to decline to proceed with an action for money damages against two individuals when at that time, even before the full testimony on the merits, it is highly probable, if not conclusively apparent, that there were not then and would not later be any damages at all?

As a further factor relevant to the exercise of its discretion by the Court, there is the bar or defense of the statutes of limitation. The applicable statutes of four states were pleaded [Tr. pp. 24-25]. The notice to dismiss at the close of the case rested in this particular on the statutes of California and Delaware [Tr. pp. 588-589]. The Court believed it unnecessary to express any opinion on the matter as a separate issue (117 Fed. Supp. at 812). We believe it plain, however, that the statute of California would govern as the law of the forum; that the relevant section is the three year limitation under Section 388 of the State Code of Civil Procedure since the

matter is essentially one of alleged fraud; that such period of three years under this statute runs from discovery by the aggrieved party; that here the corporation is clearly the aggrieved party under the authorities herein specified. The basic act complained of is the approval and execution of the contract by the corporation on September 28, 1945. This action was not filed until December 15, 1948 [Tr. p. 16] which is more than three years after the act. Clearly, the corporation must be held to have discovered the facts no later than its own approval of the contract on September 28, 1945, and the time would have commenced to run on that date since under the findings the corporation was not then under any disability because of domination. All of these facts relative to the defense were presented by the parties and appear in the record. The action would appear to be barred and, even though the Court as noted did not feel it necessary to express an opinion thereon, nevertheless the existence of the defense and its probable merit are still factors to be considered in testing the exercise of discretion.

In conclusion we submit that the judgment of the Trial Court dismissing each of the causes of action is just and equitable, is realistic and in accordance with the findings which in turn are thoroughly supported by the evidence. It is submitted that the judgment of the Trial Court should be affirmed.

Respectfully submitted,
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